United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

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77-7183

United States Court of Appeals

FOR THE SECOND CIRCUIT

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

—against—

TOUCHE ROSS & Co.,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK
AND ON REMAND FROM THE UNITED STATES SUPREME COURT

TRUSTEE'S REPLY BRIEF

HUGHES HUBBARD & REED
Attorneys for Plaintiff-Appellant
Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc.
One Wall Street
New York, New York 10005
(212) WH 3-6500

Of Counsel:

JAMES B. KOBAK, JR.
JOHN W. SCHWARTZ
MELINDA J. ROBERTS

UNITED STATES
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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 77-7183

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

-against-

TOUCHE ROSS & CO.,

Defendant-Appellee.

On Appeal From The United States District Court
For The Southern District Of New York
And On Remand From The United States Supreme Court

TRUSTEE'S REPLY BRIEF

PRELIMINARY STATEMENT

Plaintiff Edward S. Redington (the "Trustee") submits this brief as trustee for the liquidation of the business of Weis Securities, Inc. ("Weis") in reply to the principal arguments contained in the answering brief submitted by defendant Touche Ross & Co. ("Touche Ross") concerning the summary and plenary jurisdiction of the District Court as a Court of Bankruptcy. This brief also addresses Touche Ross'

extraordinary request that, if jurisdiction is found to exist, this Court stay this action despite the fact that the District Court has never had an opportunity to rule on the stay issue.

ARGUMENT

I.

THE DISTRICT COURT HAD AT LEAST THE SAME PLENARY HOME COURT JURISDICTION OVER THE TRUSTEE'S CLAIMS AS A CHAPTER X COURT.

Touche Ross argues that Congress did not confer Chapter X jurisdiction on the district court supervising a SIPA liquidation but left it with exactly the same plenary jurisdiction as a district court supervising a conventional Chapter I through VII bankruptcy under Section 23 of the Bankruptcy Act (11 U.S.C. § 46). This argument is based primarily on the erroneous premise that Section 6(c)(1) of the 1970 Act (15 U.S.C. § 78fff(c)(1)), which deals with the "conduct" of proceedings before Bankruptcy Judges, is a provision which defines the District Court's plenary jurisdiction, while Section 5(b)(2) (15 U.S.C. § 78eee(b)(2)), which expressly gives district courts supervising a SIPA liquidation the "powers" of Chapter X courts, is not concerned with district court plenary jurisdiction.

A perfectly orthodox reading of the statute, consistent with all four purposes of a SIPA liquidation proceeding

and in keeping with its antecedents in national bank liquidations and Chapter X proceedings as well as straight bankruptcy liquidations, is to read the "powers" language in Section 5(b)(2) for what it is - jurisdictional - and to read Section 6(c)(1) for what it purports to be - a guide to proceedings before the Bankruptcy Judge.[1] The indirect reference to Section 23 in Section 6(c)(1) cannot supersede the grant of plenary jurisdictional power in Section 5(b)(2) because Section 6(c)(1) states that its provisions apply "[e]xcept as inconsistent" with other provisions of the 1970 Act.

Touche Ross contends that this straightforward reading is wrong but offers no explanation why Congress would define plenary jurisdiction through oblique and labyrinthine cross-references or why Congress would insert these cross-references as inconspicuously as possible in an unexpected portion of the statute. Touche Ross also has no explanation of what "powers" Congress referred to in Section 5(b)(2) if it was not referring to jurisdictional powers. In its

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1. Touche Ross harps on the fact that the Trustee did not specifically cite Section 5(b)(2) in his complaint as a basis for jurisdiction. (Touche Ross Brief at 10, 12.) However, as explained in our principal brief, it is the operation of Sections 2a(7), 102 and 115 of the Bankruptcy Act, 11 U.S.C. §§ 11a(7), 502 and 515 (as made applicable by the reference to "powers" of a Chapter X Court in Section 5(b)(2) of the 1970 Act), which confer jurisdiction on the District Court. These provisions were all recited in the complaint.

original brief Touche Ross explained that the reference was surplusage. See Touche Ross' Original Brief at 82-83 and n.60. Now it offers no explanation at all.

Exchange Nat'l Bank v. Wyatt, 517 F.2d 453 (2d Cir. 1975), upon which Touche Ross heavily relies (Touche Ross Brief at 18-19, 23,, does not support Touche Ross' argument regarding the effect of Section 23. That case dealt only with the question whether the 1970 Act authorized a reference of the liquidation proceedings by the District Court to the Bankruptcy Judge and did not deal with the plenary jurisdiction conferred by the 1970 Act on the court supervising the liquidation. The Trustee has never contended that Section 23 and the other provisions of Chapters I-VII of the Bankruptcy Act referred to in Section 102 of that Act have no application to SIPA liquidations under the 1970 Act. Those provisions do apply to regulate the conduct of summary and administrative proceedings before the Bankruptcy Judge. They do not, however, define the plenary jurisdiction of the District Court.

Touche Ross focuses on language in Section 5(b)(2) conferring on the SIPA court "exclusive jurisdiction of the debtor involved and its property wherever located." It italicizes this language and then argues at length what no one has ever disputed: that a grant of "exclusive jurisdiction of the debtor * * * and its property" is generally interpreted as a

grant of summary jurisdiction, not plenary jurisdiction. (Touche Ross Brief at 24-29.)

Touche Ross' emphasis misstates the issues on this appeal. The Trustee has never suggested that it is the "exclusive jurisdiction" language in Section 5(b)(2) which provides the predicate for the exercise of Chapter X plenary jurisdiction over claims by the Trustee against third parties. Rather, it was by providing the SIPA court in Section 5(b)(2) with the "power" of a Chapter X court that Congress conferred the full plenary jurisdiction of a Chapter X court in addition to exclusive summary jurisdiction over the debtor and its property. "Power" is a jurisdictional word. It is the quintessentially jurisdictional word. Article III of the Constitution speaks of "Judicial Power," and the cases cited at pages 11-12 of our original brief, as well as Section 2b of the Bankruptcy Act, all equate "power" with "jurisdiction."[2]

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2. Moreover, as pointed out in our principal brief (Trustee's Brief at 14 and n.8), if Section 6(c)(1) were regarded as having any impact on plenary jurisdiction, its incorporation of Chapter X would bring into play Section 115 of the Bankruptcy Act, a provision which would give the district court at least the same ancillary "home court" jurisdiction as a federal equity receivership court. Such jurisdiction is more than adequate to support the Trustee's claims in this case.

   In response, Touche Ross argues primarily that Section 115 is not a jurisdictional provision. (Touche Ross Brief at 29-36.) As the Supreme Court noted in Williams v. Austrian, 331 U.S. 642, 659-60 n.45 (1947), however, Section 115 has been accepted as jurisdictional in every case which has either implicitly or explicitly dealt with the question

[footnote continued on next page]

Furthermore, contrary to Touche Ross' argument (Touche Ross Brief at 22-24, 34), the nature and purposes of SIPA proceedings support the existence of Chapter X jurisdiction in the district court supervising the liquidation. A SIPA liquidation is only a quasi-bankruptcy. It involves some elements of a traditional bankruptcy, some elements of a corporate reorganization, some elements of a national bank liquidation and some unique elements based on the nature of the securities industry. The entire proceeding is animated by a Congressional concern for prompt yet complete marshalling

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[footnote continued]

of its jurisdictional aspect. The cases are cited at page 14 n.8 of our principal brief. The principal spokesman for the final version of Section 102 himself regarded Section 115 and its predecessor, Section 77B(a), as jurisdictional provisions. See 2 J. Gerdes, Corporate Reorganizations § 908 at 1478 (1936).

Touche Ross' argument regarding the jurisdictional effect of Section 115 is based primarily upon case law arising under former Section 77B of the Bankruptcy Act, the predecessor to Chapter X. However, these decisions were not based on Section 115 as it now stands; they involved the different configuration of provisions which appeared as part of Section 77B, but which do not appear in Section 115, i.e. subsections 77B(a) and 77B(o) (Act of June 7, 1934, Pub. L. No. 73-296, §§ 77B(a),(o), 48 Stat. at 912, 922). The interplay of subsection (o) with subsection (a) was the dispositive factor in the cases such as In re Prudence Bonds Corp., 75 F.2d 262, 263 (2d Cir. 1935); United States v. Tacoma Oriental S.S. Co., 86 F.2d 363, 368 (9th Cir. 1936); In re Standard Gas & Electric Co., 119 F.2d 658 (3d Cir. 1941); and In re Prima Co., 98 F.2d 952 (7th Cir. 1938), cert. denied, 305 U.S. 658 (1939), relied on by Touche Ross. There is, however, no counterpart to subsection (o) in Section 115.

of assets, distribution of property to customers and recoupment by the Securities Investor Protection Corporation of advances made to pay customer claims. See Sections 6(a)(1)-6(a)(4) of the 1970 Act (15 U.S.C. §§ 78fff(a)(1)-(a)(4)).[3] The district court presiding over a SIPA proceeding and the Trustee administering such a proceeding have duties to see that these Congressional purposes are achieved. Congress must have intended that they have a jurisdiction commensurate with their duties.

Home court jurisdiction would avoid piecemeal and unnecessarily protracted litigation when exclusive jurisdiction would lie in the federal courts in litigation under the Securities Exchange Act of 1934 (to which SIPA was technically an amendment) over some participants but not others in closely related transactions. Cf. In re Penn Central Transportation Co., 419 F. Supp. 1376, 1385 (E.D. Pa. 1976), infra at p. 10 & n.6. Home court jurisdiction would also provide prompt resolution of

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3. Citing Section 6(a)(4) of the 1970 Act, Touche Ross asserts at page 22 of its brief that the "overriding purpose of a SIPA proceeding is to liquidate the business of the debtor." Liquidating the business of the debtor is, however, only the fourth and last enumerated purpose of a SIPA liquidation as set forth in Section 6(a). The other articulated Congressional purposes are to return specifically identifiable property to customers of the debtor, to make distributions to customers from the single and separate fund of customer property or advances from the Securities Investor Protection Corporation, to complete open contractual commitments of the debtor and to enforce rights of subrogation. See Sections 6(a)(1)-6(a)(3) of the 1970 Act.

actions to recover fund property (such as excess hypothecated margin securities) held by local banks which may assert adverse claims sufficiently colorable to be beyond the summary jurisdiction of the Bankruptcy Judge. The Trustee in a SIPA liquidation prepares a report similar to that prepared by a Chapter X trustee under Section 167(3) of the Bankruptcy Act (11 U.S.C. § 567(3)). See Section 6(i) of the 1970 Act (15 U.S.C. § 78fff(i)). It is anomalous to impose these duties on the Trustee and deprive him of the jurisdiction to pursue expeditiously any malefaction or misconduct he discovers.

Contrary to Touche Ross' argument, broad district court jurisdiction would be far from superfluous in SIPA liquidation proceedings and would implement the Congressional purposes involved in SIPA liquidations. Nothing in Section 6(c)(1) or any other part of the 1970 Act detracts from such a jurisdictional grant.

II.

THE DISTRICT COURT HAD SUMMARY JURISDICTION OVER THE TRUSTEE'S CLAIMS BECAUSE TOUCHE ROSS CONSENTED TO SUCH JURISDICTION.

The District Court had summary jurisdiction over the Trustee's claims against Touche Ross because Touche Ross consented to that jurisdiction by filing two proofs of claim in the Weis liquidation proceedings. As demonstrated in our principal brief (Trustee's Brief at 15-25),

Touche Ross' claims are both logically related to and mutual with the Trustee's claims against Touche Ross. Consequently, Touche Ross has consented to the exercise of summary jurisdiction by the District Court with respect to the Trustee's claims even if Section 23 applies as a limitation on the plenary jurisdiction of the District Court.

A. By Filing A Claim Touche Ross Could Consent To Summary Jurisidction Over An Action Such As This.

Touche Ross challenges the conclusion that summary jurisdiction exists by engaging in a semantic characterization of the Trustee's claims as constituting a "plenary action," apparently because it was filed initially in the district court rather than before the bankruptcy judge. (Touche Ross Brief at 36.) But Touche Ross neglects to give a single reason, much less cite a single case, in support of the proposition that such a claim may not also be asserted under the district court's summary jurisdiction against one who has consented to such jurisdiction.[4]

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4. In this case, the Trustee has proceeded in the first instance in the District Court. One reason was that the other jurisdictional bases for the Trustee's action could be invoked in the District Court, but not before the Bankruptcy Judge. However, since it is the District Court, not the Bankruptcy Judge, that is given summary jurisdiction as a Court of Bankruptcy under Sections 2 and 23 of the Bankruptcy Act, consent to the jurisdiction of a Court of Bankruptcy is consent to the summary jurisdiction of the District Court, not consent solely to the jurisdiction of the Bankruptcy Judge. (Trustee's Brief at 18-19 n.11.) In any event, the remedy for bypassing the Bankruptcy Judge should not be outright dismissal of the complaint, but a remand with directions that the Trustee's complaint be committed to the Bankruptcy Judge.

B. Consent To Summary Jurisdiction Existed Because Of The Logical Nexus Between The Trustee's And Touche Ross' Claims.

Touche Ross also argues that it has not consented to the summary jurisdiction of the Bankruptcy Court. This argument glosses over the logical relationship and close evidentiary nexus between the Trustee's claims and the two claims filed by Touche Ross in the Weis liquidation. See Trustee's Brief at 19-21. Not only were some of Touche Ross' claims directly related to "documentation of alleged fraudulent bookkeeping practices"[5] but other claims were based on Touche Ross' ongoing relationship as Weis' accountants. Because of this "ongoing business relationship," the Trustee's claims and Touche Ross' claims "present one picture" rather than two. See In re Penn Central Transportation Co., 419 F. Supp. 1376, 1383 (E.D. Pa. 1976).[6] In that case, which was decided under a compulsory counterclaim standard for finding consent which is not applied in this Circuit, the court recognized that "events separate in time may well be logically related * * *."

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5. Touche Ross' apparent attempt to assert a priority claim by its characterization of this work as "services rendered for benefit of estate" did not alter the fact that the claim was based on services performed by Touche Ross prior to the May 30, 1973 decree ordering the liquidation of Weis. Consequently, Touche Ross' suggestion that these claims are "unrelated" to the Trustee's pre-liquidation claims (Touche Ross Brief at 44 n. 38) is incorrect.

6. Shepard's Federal Citations (Pt. II), Vol. 69, No. 4 (July, 1979) incorrectly lists this decision as having been vacated at 570 F.2d 1189 (3d Cir. 1978). Mr. Hansen of Shepard's confirmed that the error will be corrected.

Id. Similarly, Touche Ross' claims regarding its ongoing role as Weis' accountants, including its investigation of alleged fraudulent bookkeeping practices, are logically related to the Trustee's claims that Touche Ross' audit in 1972 was inadequate and led to Weis' eventual demise in 1973.

Touche Ross also asserts that the exercise of summary jurisdiction by consent extends only to claims which meet the standard for "compulsory counterclaims." (Touche Ross Brief at 41.) This rigid formulation, however, ignores the principle in this Circuit that

> "* * * [i]n determining whether a particular controversy falls within the bankruptcy court's summary powers, the courts have recognized that Congress has not rigidly delineated the boundaries of jurisdiction. * * *" (In re Eastern Freight Ways, Inc., 577 F.2d 175, 182 (2d Cir. 1978).)

This concept is particularly applicable in the context of consent to summary jurisdiction:

> "* * * [I]t is somewhat anomalous for [the claimant] to concede that the bankruptcy court could decide one side of the question but not the other. Indeed, '[o]nce consent to the summary jurisdiction of the bankruptcy court appears, that jurisdiction generally will be retained for the determination of all the claims of the parties and for enforcement of all their rights against each other.' 2 Collier on Bankruptcy ¶ 23.08[1], at 536 (14th ed. 1976)." (In re Eastern Freight Ways, Inc., supra, at 183 n.16.)

The only limitation placed on this principle is that the issues raised by the claims not be "entirely disconnected." Id. That can scarcely be said of claims involving similar accounting services performed by the same auditors for the same client in successive time periods. In addition to the specific evidentiary overlap present here, by filing a claim for 1973 auditing services, Touche Ross also threw open to possible controversy before the SIPA court any basic deficiencies in the auditing standards and procedures it applied in its examinations of Weis during the period Touche Ross was its auditor. See also Trustee's Brief at 16-21 and cases cited therein.

C. Consent To Summary Jurisdiction Existed Because The Claims Were Mutual.

Although the claims between the parties here are closely related, summary jurisdiction would exist even if there were no nexus between them other than "mutuality" under Section 68 of the Bankruptcy Act.

Citing Collier, Section 57g of the Bankruptcy Act, and Daniel v. Guaranty Trust Co., 285 U.S. 154 (1932), Touche Ross contends that in cases involving consent to jurisdiction the "mutuality" concept of Section 68 of the Bankruptcy Act (11 U.S.C. § 108) must be limited to the precise holding of Katchen v. Landy, 382 U.S. 323 (1966). Collier, however, adopts a somewhat different position:

> "* * * In Katchen v. Landy, the Supreme Court allowed the exercise of summary jurisdiction on the basis of the filing of a proof of claim where the trustee sought to recover a voidable preference from the creditor. The basis for the holding was application of § 57g requiring disallowance of a claim asserted by one who had received a voidable preference. While § 57g is not applicable to the set-off situation of § 68, many of the same reasons as herein expressed are present in both cases. It would certainly appear likely that the bankruptcy court may proceed by way of summary jurisdiction where a compulsory counterclaim is involved, and it should not be prohibited from so proceeding even if the counterclaim is merely permissive." (4 W. Collier, Bankruptcy ¶ 68.20[4] at 951 (14th ed. 1978) (footnote omitted).)

See also In re Eastern Freight Ways, Inc., supra, 577 F.2d at 183; Cherno v. Engine Air Service, Inc., 330 F.2d 191, 193 (2d Cir. 1964); Conway v. Union Bank of Switzerland, 204 F.2d 603, 607 (2d Cir. 1953); United States v. Roth, 164 F.2d 575, 578 (2d Cir. 1948).

Daniel v. Guaranty Trust Co., 285 U.S. 154 (1932) is inapposite. That case did not involve a claim against a bankrupt or "mutual debits and credits" but a petition seeking reclamation of specific property of the claimant, a situation to which the Section 68 setoff provisions do not ordinarily apply. Moreover, even in the context of reclamation, Daniel has been interpreted by this Court as establishing merely that "consent as to one matter might not be considered consent as to another matter" where the issues are "entirely

disconnected." In re Eastern Freight Ways, Inc., supra, 577 F.2d at 183 n.16. The claims here are clearly not "entirely disconnected."

As set forth at pages 22-25 of our principal brief, when a creditor files a claim in bankruptcy, the rationale of Katchen v. Landy should extend summary jurisdiction to any claim by a trustee capable of being set off as "mutual" under Section 68.

III.

THIS COURT SHOULD ADHERE TO ITS EARLIER ORDER REMANDING THE QUESTION OF A STAY OF THIS ACTION TO THE DISTRICT COURT.

This Court has already rejected Touche Ross' request for a stay and held that the District Court should determine the stay issue on remand. 592 F.2d at 625 and case cited at n.15. No compelling reason appears why this Court should now deviate from its prior determination or from orthodox appellate procedure and entertain Touche Ross' renewed request for a stay before the District Court has had an opportunity to rule on the question.

The issue of whether to grant a stay is not nearly as clearcut as Touche Ross would have it. For example, the State court action has not, as Touche Ross suggests (Touche Ross Brief at 3, 7, 49-50), assumed some degree of precedence

over this one. The State court action was commenced as a precautionary measure, ten months before this one, and only in the most technical, ephemeral sense: by service of a summons without complaint. By letter agreements among the parties, no complaint was immediately served or demanded; in fact, the complaint in the State court action was ultimately served only after the complaint in this action had been filed. It is the rule in this Circuit that "the determination of priorities between pending [federal and state] cases on the basis of dates of filing is not to be applied in a mechanical way regardless of other considerations." Telechron, Inc. v. Parissi, 197 F.2d 757, 762 (2d Cir. 1952). See also Hammett v. Warner Brothers Pictures, Inc., 176 F.2d 145, 150 (2d Cir. 1949); Georgia Pacific Corp. v. County of Mendocino, 340 F. Supp. 1061 (N.D. Cal. 1972), aff'd, 515 F.2d 285 (9th Cir. 1974).

Touche Ross exaggerates when it claims that the proceedings in the State court action have advanced beyond proceedings in this case. (Touche Ross Brief at 14, 49.) Discovery in neither action has progressed significantly as both sides have awaited resolution of the federal jurisdictional issues by the Supreme Court and this Court. In this action, for example, apart from the litigation over the jurisdictional issues, plaintiffs have already served a short set of interrogatories and received answers from defendant.

The sum total of all the progress in the State court action to date has been that defendant has propounded a bulkier set of interrogatories, the substance and form of plaintiffs' final answers to which are still under negotiation.

CONCLUSION

For the foregoing reasons, the order of the District Court should be reversed on the issue of subject matter jurisdiction over the Trustee's non federal claims and the case remanded for further proceedings, including consideration of whether the action should be stayed.

Dated: New York, New York
October 22, 1979

Respectfully submitted,

HUGHES HUBBARD & REED
Attorneys for Plaintiff-Appellant
Edward S. Redington, as Trustee for
the liquidation of the business of
Weis Securities, Inc.
One Wall Street
New York, New York 10005
(212) 943-6500

Of Counsel:

James B. Kobak, Jr.
John W. Schwartz
Melinda J. Roberts

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

AFFIDAVIT
OF SERVICE

Michael J. Lonergan, being duly sworn, deposes and says that he resides at 86 Ogden Avenue, White Plains, N.Y. 10605

; that on the 22nd day of October, 1979, he served the within Trustee's Reply Brief

on the attorneys for Π - Appellant Securities Investor Protection Corp. & Δ - Appellee Touche Ross & Co.

herein by mailing 2 true copies thereof, securely enclosed in a post-paid, properly addressed wrapper, in the mail box under the exclusive care and custody of the United States Postal Service at the corner of Wall Street and Broadway, New York, New York, addressed to said attorneys as follows:

Philip R. Forlenza, Esq.
Hawkins Delafield & Wood
67 Wall St
New York, New York 10005

Arnold I. Roth, Esq.
Rosenman Colin Freund
Lewis & Cohen
575 Madison Avenue
New York, New York 10022

The above addresses have appeared on the prior papers in this action as the office addresses of said attorneys.

Deponent is over the age of 18 years and not a party to this action.

Michael J. Lonergan

Sworn to before me this
22nd day of October, 1979.

Teresa Pernetti
Notary Public

TERESA PERNETTI
Notary Public, State of New York
No. 41-8329300
Qualified in Queens County
Certificate filed in New York County
Commission Expires March 30, 1980